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M E M O R A N D U M

April 26, 1994

TO: William E. Kennard

FROM: Frank Washington

Re: Minority Ownership Policies

In response to your request following the meeting with Chairman Hundt on March 30, 1994, I am enclosing a memorandum on the constitutionality of the FCC's auction preferences. Toni Cook Bush and Marc Martin at Skadden Arps assisted me in the preparation of this memo. As I will be out of town the next few days, please feel free to call them at (202) 371-7230 if you have any questions or comments. You can reach me in my office next week at 916-921-2290.

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M E M O R A N D U M

April 26, 1994

Re: Constitutionality of 2 GHz PCS Auction
Preferences for Minority-Owned Businesses

I. Introduction

Section 309(j)(4)(D) of the Communications Act of 1934 (the "Act") directs the Commission to ensure the economic opportunity of small businesses, rural telcos, and businesses owned by women and minorities (the "designated entities") under a system of competitive bidding. In the Second Report and Order of PP Docket No. 93-253 ("Auction Order"), the Commission adopted a "menu" of preferences, including set-asides, bidding credits, tax certificates and installment payments, for the designated entities that will apply in specific services (such as PCS) as determined in future Reports and Orders. There have been some concerns raised regarding the constitutionality of preferential measures for the designated entities. See Notice of Proposed Rule Making in PP Docket No. 93-253, paras. 73-76 ("Auction Notice"). This memorandum focuses the constitutionality of preferences for minority-owned businesses in the 2 GHz PCS context. It concludes that the applicable case law provides a legally sound basis for the FCC to adopt tax certificates, installment payments, bidding credits and set-asides in the broadband PCS context.

II. Case Law

a. Metro Broadcasting, Inc. v. FCC

Recently, the Supreme Court in Metro Broadcasting, Inc. v. FCC, 497 U.S. 547 (1990)("Metro"), upheld as constitutional the Commission's policy of awarding preferences to minority applicants for broadcast stations and its broadcast license distress sale policy. The Metro Court held that benign race-conscious measures mandated by Congress -- even those measures not "remedial" in the

sense of being designed to compensate victims of past governmental or societal discrimination -- are constitutionally permissible to the extent that they serve important governmental objectives within the power of Congress and are substantially related to achievement of those objectives. Id. at 564-565. As discussed below, the Court explained how the FCC's minority broadcast measures met the test adopted in Metro.

Although the Court in Metro did not explicitly define the term "benign" for purposes of its test, it implied that the burden imposed by race-conscious preferences on persons who fall outside the race classification must be "relatively light" in order to be benign. Id. at 598-599 (quoting Fullilove v. Klutznick, Secretary of Commerce, 448 U.S. 448, 484 (1980)("Fullilove"). A race-conscious measure may therefore require "a sharing of the burden by innocent parties" and still be benign. Id. at 597. Id. at 597 (quoting Fullilove, 448 U.S. at 521). Because the award of a broadcast preference in a comparative hearing or transfer of a station in a distress sale contravenes no "legitimate firmly rooted expectations" of competing applicants, the Metro Court found that the FCC's broadcast diversity policies did not overly burden non-minorities. Id. at 597. No such expectations are contravened, according to the Metro Court, because the Commission must still consider public interest factors in addition to the awarded preference before determining whether to grant a broadcast license. Id. at 598-599. In addition, the distress sale measure is only invoked with respect to a small fraction of broadcast licenses, and it is not a "quota or fixed-quantity set-aside." Id.

Justice Stevens strongly implied in his concurring opinion that he broke with his voting record to join the Opinion of the Court in Metro because the FCC's minority preferences did not unfairly stigmatize minorities nor non-minorities. Metro, 497 U.S. at 601 (citing his own opinions in Richmond v. J.A. Croson Co., 488 U.S. 469, 516-517 (1989)("Croson"), and Fullilove, 448 U.S. at 545 and n. 17, where he refused to uphold race-conscious preferences because they failed to meet his "stigma" test); and at 596 and n. 49 (where the Opinion of the Court appears to utilize Stevens' "stigma" test)). Specifically, Justice Stevens found that the Commission's preferences did "not imply any judgement concerning the abilities of owners of different races or the merits of

different kinds of programming." Id. at 601. By contrast, Justice O'Connor's dissenting opinion in Metro, joined by Chief Justice Rehnquist, and Justices Kennedy and Scalia, argued that the phrase "benign racial classification" is a "contradiction in terms." Id. at 609.

Under the Metro test, benign race-conscious preferences must be adopted at the direction of Congress in order to be subject to an intermediate level of scrutiny. Id. at 563.[1] The Congressional mandate must also be clearly within Congress' delegated constitutional powers in order to be afforded some degree of deference by the Court.[2] Thus, Metro applied an intermediate scrutiny test to the Commission's broadcast ownership diversity policies because they were adopted pursuant to a Congressional directive that was within the constitutionally delegated powers of Congress. Id. at 564-566.

Finally, race-conscious measures must serve important governmental objectives and be substantially related to such objectives. Id. at 566-567. The Metro Court noted that the objective of the Commission's minority ownership policies was to encourage minority ownership, and thereby promote the interests of the First

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[1] Metro, 497 U.S. at 563-565, n. 11 and 13 (distinguishing Croson, where a race-conscious preference approved by a local municipality was struck down by the Court under a strict scrutiny test, from Fullilove, where a Congressionally mandated race-conscious measure was upheld).

[2] In Metro's dissent, Justice O'Connor (who wrote the Court opinion in Croson) argued that under Croson, only measures enacted pursuant to the special "remedial" powers of Congress under clause 5 of the XIV Amendment can be afforded some deference by the Court. Id. at 606-607. The Metro Court expressly disagreed and noted that the preference in Fullilove was afforded deference by the Court because, inter alia, "Congress employed an amalgam of its specifically delegated powers" under the Commerce Clause, the Spending Clause and the Civil War Amendments of the Constitution. Id. at 563 and n. 11 (citing Fullilove, 448 U.S. 473-478). Therefore, the FCC's non-remedial broadcast diversity measures were found constitutional in Metro.

Amendment by encouraging a programming diversity. Id. at 566-600. The Metro Court found that Congress and the Commission had developed a comprehensive and convincing record of empirical evidence which demonstrated a nexus between minority ownership and programming diversity. Id. at 569. As a result, the Court decided that it is "required to give great weight to the decisions of Congress and the experience of the Commission" regarding this complex empirical question. Id. Therefore, the Court found that the Commission's minority preferences were substantially related to an important governmental objective for purposes of the intermediate scrutiny test. Id.

b. Fullilove

In Fullilove, the Court affirmed a race-conscious preferential measure mandated by the Public Works Employment Act of 1977)("PWE"). Id. at 456. The PWE required that, absent an administrative waiver, at least ten percent of federal funds granted for local public works projects must be used by the state or local grantee to procure services or supplies from "minority business enterprises" ("MBE"). Id. at 456-463. The program, implemented and administered by the Small Business Administration ("SBA"), provided an administrative mechanism to ensure that only bona fide MBE's are eligible for the program, and to prevent unjust participation by minority firms whose access to public contracting is not impaired by the effects of prior discrimination. Id.

The Court in Fullilove upheld the SBA-MBE program because it found its objectives to be within Congress' constitutionally delegated powers. Id. at 472-480. Specifically, the Court held that the PWE was an exercise of an "amalgam" of constitutional powers delegated to Congress under the Spending Clause, the Commerce Clause and the Civil War Amendments. Id. at 476-478. In addition, the Court found the PWE to be properly tailored because of its waiver and exemption criteria to safeguard against participation by MBE's that are not bona fide. Id. at 486-489.

c. Application of the Case Law to the FCC's PCS Auction Preferences for Minority-Owned Businesses

As noted above, the Auction Order adopted a menu of race-conscious preferences to ensure the economic opportunity of, among other entities, minority-owned businesses under a system of competitive bidding. Under the case law discussed here, such measures would have to 1) be considered benign, 2) adopted pursuant to a Congressional mandate that is within Congress' constitutionally-delegated powers, and 3) serve an important governmental objective that serves important governmental interests and be substantially related to that objective, in order to be applied to PCS.

i. Must be Benign

Set-asides may be considered benign upon judicial review because, even though they would exclude non-minority owned businesses (that are also not eligible as one of the other designated entities), the burden would be "relatively light" as the ten percent set-aside was in the Fullilove (discussed below).[3] See Fullilove, 448 U.S. at 521. If the original licensing plan is affirmed on reconsideration, the set-aside spectrum blocks would involve the smaller, less valuable PCS spectrum blocks available to bidders (20 MHz and 10 MHz) instead of the largest, most valuable blocks (30 MHz). In addition, the two set-aside blocks would constitute a distinct minority of the seven blocks subject to auction. Further, auction set-asides would not create a "firmly rooted legitimate expectation" among competing applicants because, as in Metro, the Commission would still consider public interest factors after the auction before granting a license.

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[3] But see Metro, 497 U.S. at 592 (noting that the Commission rejected "expansive" measures such as spectrum set-asides for minority broadcasters) and 599 (noting that the distress sale policy is not a set-aside). This language from Metro may be distinguishable on the basis that Metro did not involve competitive bidding, where the need to ensure the economic opportunity of applicants is far greater than under a lottery system, for which only a nominal fee (if any) is required to participate.

The other preferences adopted in the Auction Order, bidding credits, installment payments and tax certificates, also appear to be benign. Bidding credits would merely enhance the economic opportunity of the minority bidder without excluding non-minority bidders from bidding for any PCS spectrum. Moreover, installment payments would merely facilitate the ability of the minority auction winner to finance its bid payments. Tax certificates are an entirely voluntary measure that would encourage the participation of minorities in the provision of PCS. In addition, none of the adopted preferences would stigmatize minority PCS bidders by implying any judgement concerning the abilities of owners of different races. Therefore, such measures would appear to be benign for purposes of the Metro test.

ii. Adopted Pursuant to a Congressional Mandate

Section 309(j)(4)(D) of the Communications Act requires the Commission to ensure that minority-owned businesses are given the opportunity to participate in the provision of spectrum-based services under a system of competitive bidding, and, for such purposes, consider the use of tax certificates, bidding preferences and other procedures. By this law, Congress clearly mandated that the FCC adopt measures that would ensure the economic opportunity of minority-owned businesses in both the bidding context and in the post-auction financing context. Set-asides and bidding credits are both designed to assist the auction bidder; and tax certificates and installment payments are designed to assist the auction winner. Therefore, set-asides, bidding credits, tax certificates and installment payments are clearly within Congress' mandate.[4]

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[4] Although Congress did not define the term "bidding preferences," it appears that Congress intended the term to embrace any measures that would assist bidders, including bidding credits and set-asides. It is unlikely that the term was a reference to "bidding credits" exclusively, because there is no discussion of "bidding credits" anywhere in the subject statute or the legislative history.

Although Congress clearly intended tax certificates, bidding credits and installment payments to be within its statutory mandate, it is somewhat less clear whether Congress intended set-asides to be within its statutory mandate.[5] For example, John Dingell, Chairman of the House Energy and Commerce Committee ("Committee"), stated in a letter to the Chairman, FCC, on September 21, 1993, that Congress declined to enact 2 GHz PCS auction set-asides for rural telephone companies ("rural telcos") exclusively during the course of the Committee's consideration of the Budget Act.[6] According to Congressman Dingell, the House-Senate Conference also declined to enact a provision to set-aside 2 GHz PCS spectrum for rural telcos. Congressman Dingell, therefore, expressed concern about the possible adoption of set-asides by the FCC for the designated entities generally. He conceded, however, that the subject statutory directive provided the Commission with significant latitude to adopt a variety of preferential measures, and did not state that he was opposed to set-asides.

Congress' failure to enact a rural telco set-aside, however, is only evidence that Congress did not want rural telcos to have an exclusive set-aside. It is not evidence that Congress intended to reject set-asides as a means to assist designated entity bidders generally. Congress could have inserted broad prohibitive language in the statute or legislative history, but did not. Therefore, it appears that set-asides, in addition to the other preferential measures adopted by the FCC, were intended to be within Congress' broad mandate.

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[5] Tax certificates and "bidding preferences" are specifically mentioned in Section 309(j)(4)(D). Installment payments are specifically mentioned in Section 309(j)(4)(E). See also, Conference Report, H. Conf. Rep. No. 103-213, 1162, 1172(1993).

[6] See Comments of Bellsouth in PP Docket 93-253 (noting this aspect of the Budget Act's legislative history to argue against adoption of set-asides).

iii. Must Serve an Important Governmental Interest within Congress' Constitutionally Delegated Powers and be Substantially Related to the Objective

The Court in Metro affirmed the Commission's broadcast diversity policies as constitutional because they served important First Amendment interests in programming diversity. Metro, 497 U.S. at 566-601. The holding in Metro, however, is not restricted to measures that only serve First Amendment interests. Id. at 572. Metro, in fact, marked a departure from Fullilove by tying minority preferences to First Amendment interests rather than, for example, the Commerce Clause and the Civil War Amendments. To support its departure, the Court in Metro noted that it had previously held that

> nothing that the Court has said today necessarily forecloses the possibility that the Court will find other governmental interests which have been relied upon in the lower courts but which have not been passed on here to be sufficiently 'important' or 'compelling' to sustain the use of affirmative actions policies.

Id. at 568 (citing Wygant v. Jackson Board of Education, 476 U.S. 267, 314-315 (1986)("Wygant")). Therefore, PCS auction preferences need not only serve the First Amendment, but may serve an "amalgam" of important interests. Metro, 497 U.S. at 563-564 and n. 11 (quoting Fullilove, 448 U.S. at 473).

PCS auction preferences clearly serve an "amalgam" of important government interests, including the Commerce Clause, the Civil War Amendments and the First Amendment. Although the Budget Act's legislative history does not reveal Congress' authority for or the interest it intended to serve by the subject statutory provision, the reviewing court may look to the history of related statutes. See Metro, 497 U.S. at 572 ("[a]fter Congress has legislated repeatedly in an area of national concern, its Members gain experience that may reduce the need for fresh hearings or

prolonged debate when Congress again considers action in that area." (quoting Fullilove, 448 U.S. at 502-503)).[7]

The relevance of the Commerce Clause to the Commission is well established, as it is the constitutional basis for its regulation of interstate and foreign communications. 47 U.S.C. §§ 151-152. PCS licensed systems, which will presumably interconnect with the public switched network, will "concern more states than one" for purposes of triggering Congress' powers under the Commerce Clause. See Gibbons v. Ogden, 22 U.S. 1 (1824). Therefore, the Budget Act's mandate is clearly within Congress' constitutionally-delegated powers under, inter alia, the Commerce Clause. See Fullilove, 448 U.S. at 473.

In addition, Congress has repeatedly relied upon the Commerce Clause and the Civil War Amendments for the proscription of discriminatory practices that have a deleterious effect on interstate commerce. See, e.g., Civil Rights Act of 1964[8] and the Civil Rights Act of 1991.[9] Congress has also relied upon the Commerce Clause and the Civil War Amendments to redress discriminatory lending practices. See, e.g., Equal Credit Opportunity Act.[10] Such legislation is intrinsically related to the Budget Act's mandate to ensure that minority-owned businesses gain access to capital to competitively bid for PCS spectrum. Therefore, such measures constitute important governmental interests because they would promote the interests of the Commerce Clause and the Civil War Amendments. Moreover, the Budget Act's man-

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[7] As noted in the Metro case, Congress has considered issues concerning minority participation in the communications industry in a wide range of hearings over the last twenty-five years. Metro, 497 U.S. at 572-579.

[8] Pub. L. No. 88-352, 78 Stat. 241 (codified as amended at 42 U.S.C. §§ 1971 and 1973).

[9] Pub. L. No. 102-166, 105 Stat. 1071 (codified at 42 U.S.C. § 1981).

[10] Pub. L. No. 93-495, 88 Stat. 1521 (1974) (codified as amended at 15 U.S.C. §§ 1691-1691(f)(1992). See also Fair Housing Act of 1968, Pub. L. No. 90-284, 82 Stat. 81 (codified as amended at 42 U.S.C. §§ 3604, 3605, and 3617 (1988)).

date enacted pursuant to such authority should be subject to intermediate scrutiny because Metro expressly rejected the notion advanced in Croson that the Court will only accord deference to "remedial" measures adopted pursuant to Congress' powers under Clause 5 of the XIV Amendment.[11] See note 2, above.

Finally, there must be a bow to marketplace reality. Increasing competition within what were true commodities services has forced differentiation in technology -- mostly based on some form of information driven, value added features. Recognizing these changes in the marketplace, the Commission loosely defined PCS to provide it with the flexibility to develop into a innovative and diverse broadband service.[12] Moreover, the Commission has recognized in the Video Dial Tone and Regulatory Parity proceedings that the traditional regulatory distinctions between Title II and Title III services have become increasingly meaningless in the face of recent technological innovations. Specifically, the Commission has conceded that it expects PCS technology "to transmit electronic publications to multiple viewers." Auction Notice at note 47. In addition, certain commenters have informed the Commission that they intend to use PCS to deliver video services.[13] In this manner, PCS is analogous to the Multipoint Distribution Service ("MDS"), a wireless common carrier service that delivers video programming. Under Section 309(i), MDS is a "media of mass communica-

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[11] Intermediate scrutiny would apply provided, of course, that the other aspects of the Metro test are met.

[12] See 47 C.F.R. § 99.5 (The definition of PCS includes "[v]ery broadly defined and flexible radio services that encompass a wide array of mobile and ancillary communication services, which could provide services to individuals and businesses, and be integrated with a variety of competing networks.").

[13] See, e.g., Comments of Time Warner Communications before the FCC En Banc Meeting on PCS Issues (April 12, 1994)("While PCS operators initially will focus on voice applications, Time Warner anticipates that, within a relatively short time period, the "digital-friendly" nature of the new PCS networks will lead to the introduction of an array of un-tethered data and imaging applications").

tions" eligible for the minority preferences upheld in Metro.[14] Therefore, the Commission could conclude that its PCS auction preferences would promote the interests of, in addition to the Commerce Clause and the Civil War Amendments, the First Amendment.

Set-asides and the other subject measures would be properly tailored to the governmental objective because, consistent with Fullilove, the FCC adopted safeguards and eligibility restrictions to prevent the unjust enrichment of entities other than those designated by the Budget Act. See generally, Auction Order, __ FCC Rcd __ (1994). In addition, the auction preferences would address minority-owned businesses' lack of access to capital and other financial barriers to their participation in spectrum-based services that are particularly acute under a competitive bidding licensing scheme. Set-asides, for example, would limit the universe of potential bidders to the eligible designated entities, and thereby ensure an economically fairer bidding environment. Similarly, tax certificates, bidding credits and installment payments all directly concern financial barriers to minority participation in the licensing of PCS by competitive bidding. The Commission has two sources of evidence with which to conclude that its auction preferences are substantially related to its objective: 1) the empirical data arising from the Commission's related broadcast ownership diversity policies, and 2) the record evidence arising from the auction proceeding.[15]

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[14] Cf., Cellular Mobile Systems of Tampa, CC Docket No. 83-661, Memorandum Opinion and Order, 98 FCC 2d 231, 234 (1984) (where the Commission declined to adopt minority preferences to cellular applicants because "the purpose underlying the special consideration given to encouraging minority participation in mass media services - diversity of broadcast content - is absent in common carrier services such as cellular radio.")(Emphasis added). In 1984, however, no one envisioned that cellular radio would involve the delivery of video services and other innovative broadband applications, as in the case of PCS today.

[15] See, e.g., the Federal Communications Commission Small Business Advisory Committee Report (September 15, 1993), and the following comments filed in PP Docket No.

(continued...)

III. Conclusion

Under the applicable case law, it is very likely that tax certificates, installment payments and bidding credits would be found constitutional as auction preferences for minority-owned businesses under an intermediate scrutiny test. Specifically, it appears that the preferences serve an "amalgam" of important governmental interests, including the Commerce Clause, the Civil War Amendments and the First Amendment, by ensuring the economic opportunity of minority-owned businesses. Although spectrum set-asides would also serve important governmental interests, it is possible that they might be somewhat more vulnerable to a constitutional challenge because they limit the bidding opportunities of certain parties. The ten-percent set-aside for minority business enterprises upheld in Fullilove and affirmed in Croson and Metro, however, provides precedent for the FCC to adopt set-asides for certain spectrum blocks in the 2 GHz PCS context despite the expectation of such a challenge.

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[15](...continued)
93-253: Comments of American Women in Radio and Television, Inc., National Association of Black-Owned Broadcasters, Inc., Minority PCS Coalition, Windsong Communications, the National Association of Minority Telecommunications Executives and Companies, and Joint Reply Comments of the United Church of Christ and Georgetown University Law Center; see also, Comments of Mr. George Murray in both PP Docket No. 93-253 and before the FCC's En Banc Meeting on PCS Issues (April 11, 1994). Many of these parties provided evidence that PCS Auction Preferences would serve the interests of the Commerce Clause, the Civil War Amendments and the First Amendment.